

TO THE  
TENNESSEE REGULATORY AUTHORITY  
NASHVILLE, TENNESSEE

IN RE:

PETITION OF BEN LOMAND )  
COMMUNICATIONS, INC. FOR APPROVAL )  
TO ISSUE AND SELL UP TO AN ADDITIONAL )  
\$1,000,000 IN COMMON STOCK OF )  
BEN LOMAND COMMUNICATIONS , INC. )

DOCKET NO. 00-00680

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RESPONSE

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Comes the Petitioner, Ben Lomand Communications, Inc. and responding to the questions set out in letter of K. David Waddell, Executive Secretary of the Tennessee Regulatory Authority, dated November 29, 2000, says:

Before answering or attempting to answer the inquiries contained in said letter, I, James W. Dempster, Attorney, am making the following preliminary statement on behalf of both my client, Ben Lomand Communications, Inc., and myself.

The answers contained hereafter are the answers of and on behalf of Ben Lomand Communications, Inc. only, and any statements contained herein are not the statements of any telephone cooperative in the state of Tennessee or in the United States of America, and in no way are any statements, comments, answers, etc. to be considered, presumed, or assumed to be statements or the policies of Ben Lomand Rural Telephone Cooperative, Inc., in particular, or any and all other telephone cooperatives in the state of Tennessee or nation generally. Neither Ben Lomand Communications, Inc. nor James W. Dempster, Attorney, have any authority, either expressed or implied, to speak on their behalf.

POSTED  
9-09-01

### QUESTION

1. To what extent does the cost allocation plan proffered by BLC at its CCN hearing address the terms and conditions concerning either BLRTC's ownership of BLC's stock equity or BLRTC's loans to BLC?

### ANSWER

The cost allocation plan proffered by BLC at the CCN hearing will have no impact or relationship to any stock sale or loans obtained from BLRTC or any other individual, corporation, or institution. The cost allocation plan is merely a mechanism to allocate joint costs between the entities. The sale of stock or the procurement of any loans is merely a way to fund the capital or operating costs after the proper allocation is made.

### QUESTION

2. To what extent is TCA § 65-5-208(c) or other state or federal law applicable to the existence of overlapping corporate directors of BLRTC and BLC who may participate in the development or execution of financing arrangements between BLRTC and BLC?

### ANSWER

Tennessee Code Annotated § 65-5-208(c) refers to a "incumbent local exchange telephone company." Neither Ben Lomand Communications, Inc., the answering party, nor its parent company, Ben Lomand Rural Telephone Cooperative, Inc., are incumbent local exchange telephone companies. Section 65-4-101 under the heading Regulation of Public Utilities by Authority, Part 1, General Provisions, Definitions, TCA 65-4-101(d) states:

"Incumbent local exchange telephone company" means a public utility offering and providing basic local exchange telephone service as defined by § 65-5-208 pursuant to tariffs approved by the commission prior to June 6, 1995.

Ben Lomand Rural Telephone Cooperative, Inc. is not a "public utility" as defined in Tennessee Code Annotated 65-4-101(a), which states in part:

... "Public utility" as herein defined shall not be construed to include the following (hereinafter called nonutilities): ...

(5) Any cooperative organization, association or corporation not organized or doing business for profit; . . .

This is one of the exclusions provided by Tennessee law. Another exclusion is TCA § 65-29-130 by the 1995 amendment which provides:

Jurisdiction of Tennessee regulatory authority. -- (a) Cooperatives and foreign corporations engaged in rendering telephone service in this state pursuant to this chapter fall within the jurisdiction of the Tennessee regulatory authority for the sole and specific purposes as set out below:

(1) [Deleted by 1995 amendment.]

(2) The establishment of territorial boundaries;

(3) The hearing and determining of disputes arising between one (1) telephone cooperative and other telephone cooperatives, and between telephone cooperatives and any other type of person, corporation, association, or partnership rendering telephone service, relative to and concerning territorial disputes;

(4) The approval of sales and purchases of operating telephone properties.

(b) Cooperatives and foreign corporations engaged in rendering telephone service in this state pursuant to this chapter fall within the jurisdiction of the comptroller of the treasury for the sole and specific purpose of assessing the cooperative property for ad valorem taxes as provided in § 65-29-129.

(c) Either party shall have the right of appeal from any ruling, order or action by the authority or the comptroller of the treasury under the procedures established by §§ 4-5-322 and 4-5-323.

Ben Lomand Communications, Inc. does fall within the jurisdiction of the Tennessee Regulatory Authority as a competing telecommunications service provider and was certified as a provider of such services as set out in TCA § 65-4-101(e) after June 6, 1995, which takes it out of the classification of incumbent local exchange telephone company, which takes it out of TCA § 65-5-208(c) as this subsection is applicable only to incumbent local telephone exchange companies.

As to the remaining portion of this question, after checking the indexes of the legislatively adopted Tennessee Code Annotated, we do not find any statutes which prohibits overlapping corporate directors nor do we have any knowledge of any federal

statute which would prohibit overlapping directors under the facts contained in TRA's Question 2.

We did, however, find innumerable statutes, both enacted by the Legislature of the State of Tennessee and federal legislative branches, which sets out standards of conduct for directors including but not limited to directors and officers conflicts of interest. The general law in the state of Tennessee and in other states, both statutory and by judicial holdings, as well as some of the federal courts, put simply is that a corporation through ownership of a majority or more of its stock in another corporation assumes a relation of trust to the minority stockholders, and in the instance of a CLEC and a cooperative assumes a relation of trust to either the minor stockholders or to the members of the parent company (Cooperative) and patrons of the subsidiary (CLEC).

Answering the question before it is asked, BLC is of the opinion that it was duly authorized to sell the stock to its parent company in that the "Telephone Cooperative Act", TCA § 65-29-104. Powers. states: "A cooperative has the power to: . . . (6) Become a member in one (1) or more other cooperatives or corporations or own stock therein; . . . ."

### QUESTION

3. On page 12 of his pre-filed direct testimony in Docket No. 98-00600, Levoy Knowles states, "Every effort will be made to ensure that BLC bore the full cost of whatever service it obtained."
  - a. What does the term "full cost" mean in the context of this quote?
  - b. As a matter of federal and state law and policy, should the "full cost" as defined in the response to part a) be comparable to the economic costs (including opportunity costs) faced by a certificated competitive telecommunications services provider ("CTSP") that is neither wholly owned by a telephone cooperative as defined by Tennessee law nor otherwise wholly owned by an ILEC that is exempt from competition under Tennessee law?

### ANSWER

3.a. In the pre-filed direct testimony of Levoy Knowles in Docket No. 98-00600, he stated "Every effort will be made to ensure that BLC bore the full cost of whatever service it obtained." In this context "full cost" refers to BLC being responsible for all costs whether they are direct or indirect. Direct costs, which represent the majority, reflect costs paid by BLC directly to vendors, employees, lessors, contractors, etc. when BLC receives goods or services. To a lesser extent, indirect costs are those common costs for services that are used by both the parent and subsidiary. These indirect costs are allocated to each entity, BLC or BLRTC, based on the service obtained. Any services provided for the sole benefit of BLC by BLRTC are reimbursed by BLC for the direct cost plus any overheads.

3.b. The interpretation of the question posed on the full costs in 3.a. is that the same costs would be incurred in the market for any other unrelated CLEC regardless of ownership. The costs incurred by BLC would be identical to those costs of any other CLEC, regardless of ownership.

### QUESTION

4. Hypothetically, if BLRTC faced competition for local exchange services, would BLRTC continue to hold 100 percent of BLC's stock or hold BLC's stock under the same terms and conditions?

### ANSWER

Though this is a hypothetical question, this answer is being made by Ben Lomand Communications, Inc., and although four of the directors of BLC serve on a nine-person board of BLRTC, the officers and management of Ben Lomand Communications, Inc. have no idea as to what the Ben Lomand Rural Telephone Cooperative, Inc. board would do as they have not been approached on this subject. It is the opinion of BLC that the Board of Directors of Ben Lomand Rural Telephone Cooperative, Inc. would, if this question arose, make a decision which, in their opinion, was in the best interest of the

members of Ben Lomand Rural Telephone Cooperative, Inc. and the public interest of the citizenry in the Ben Lomand Rural Telephone Cooperative, Inc. trade area.

### **QUESTION**

5. BLC's petition in Docket No. 99-00496 prospectively pledges, with respect to BLC's sale of stock to BLRTC, "to keep as much as possible the equities of [BLC and BLRTC] separate in that requirements of Tennessee Regulatory Authority and the FCC along with state and federal laws for all practical purposes require such a division." Please comment on how the requirements of the Authority and the FCC as well as state and federal laws would require a division between or separate ownership or control by BLC and BLRTC of the debt and stock equities of BLC and BLRTC.

### **ANSWER**

The quote "to keep as much as possible the equities of [BLC and BLRTC] separate in that requirements of Tennessee Regulatory Authority and the FCC along with state and federal laws for all practical purposes require such a division." is not an accurate quote from the petition. In the petition, II. REQUEST TO SELL STOCK, Section 2, the paragraph out of which the above quote is supposed to have been taken, is as follows:

2. It is the purpose and intent of Ben Lomand Communications, Inc. and its board of directors and management to keep as much as possible separate the resale operation of the company from the local exchange operation of the company and to keep as much as possible the equities of the two divisions of the company separate in that requirements of Tennessee Regulatory Authority and the FCC along with state and federal laws for all practical purposes require such a division.

This paragraph has reference to two divisions of Ben Lomand Communications, Inc.--one is the resell operation of Ben Lomand Communications, Inc. and the other is the competitive local exchange operation of Ben Lomand Communications, Inc. Ben Lomand Communications, Inc. has, as much as possible, kept the costs, expenses, and equities of the two divisions of Ben Lomand Communications, Inc. separate according to Ben Lomand Communications, Inc.'s interpretation of the requirements of

the Tennessee Regulatory Authority and the Federal Communications Commission with regard to resell of long distance and the furnishing of local exchange operations. If further answer or response is required, please notify Ben Lomand Communications, Inc. or its attorney.

### **QUESTION**

6. Assume Tennessee law prohibits incumbent local exchange companies, public utilities, or other entities granted exclusive service franchises as defined under Tennessee law from cross-subsidizing corporately affiliated CTSPs. Under that assumption, as a matter of law and policy, explain whether Tennessee law permits a telephone cooperative, as defined under Tennessee law, to cross-subsidize a corporately affiliated CTSP.

### **ANSWER**

The word "subsidize" is defined in Webster's II New Riverside University Dictionary, copyright 1984, as follows: "1. To support or assist with a subsidy. 2. To obtain the assistance of by granting a subsidy." Subsidy is defined in the same dictionary: "1. Financial assistance granted by a government to an individual or to a private business. 2. Financial assistance given by one person or government to another. 3. Money formerly granted to the British monarch by Parliament." Black's Law Dictionary defines subsidy: "A grant of money made by government in aid of the promoters of an enterprise, work, or improvement in which the government desires to participate, or which is considered a proper subject for government aid, because such purpose is likely to be of benefit to the public." Under the assumptions set out in Question 6, it is the opinion of the officers and management of Ben Lomand Communications, Inc. that a telephone cooperative organized and/or operating under the "Telephone Cooperative Act" could not under the cooperative's policies or the policies of the Tennessee Regulatory Authority grant a subsidy to a competitive telephone service provider and vice versa. There is not, however, in the opinion of the answerer, any law or policy which would prohibit a cooperative from investing reasonable amounts of

surplus margins, including but not limited to stocks and loans, in subsidiary corporations, corporations, joint ventures, limited partnerships, limited liability corporations, or other types of business entities.

### QUESTION

7. Please comment on whether any provisions of state or federal laws prohibit, or limit the ability of a telephone cooperative, as defined by Tennessee law, to cross-subsidize a corporately affiliated CTSP?

### ANSWER

To answer this question either yes or no would be completely misleading and incorrect. We do not find any law or provision of the Tennessee Telephone Cooperative Act or any case law which strictly prohibits the ability of a telephone cooperative, as defined by Tennessee law, to cross-subsidize a corporately affiliated CTSP, however, in enumerating the powers of a telephone cooperative, as set out in Tennessee Code Annotated 65-29-104, there is strong implication that a subsidy as commonly referred to in present day language would not be authorized:

TCA § 65-29-104. Powers. -- A cooperative has the power to: . . .

(15) Do and perform any and all other acts and things and have and exercise any and all other powers which may be necessary, convenient, or appropriate to accomplish the purpose for which the cooperative is organized.

Tennessee Code Annotated 65-29-102 specifies the purpose:

. . . for the purpose of furnishing telephone service in rural areas to the widest practical number of users of such service provided that there shall be no duplication of service where reasonably adequate telephone service is available. . . .

This quoted catchall provision along with Tennessee Code Annotated 65-29-132 (which will be discussed later) appears to give cooperatives broad discretionary authority so long as it is reasonably justifiable to accomplish the stated purpose and goals. Carried to the extreme, it might be said that a payment by a competitive local exchange



company into the Universal Service Fund might be an indirect subsidization to affiliates. Cooperatives who have loans with the Rural Telephone Bank, the Rural Electrification Administration, or CoBank, and possibly others are limited through loan instruments as to how cooperative funds may be used. Ben Lomand Communications, Inc.'s answer to Question 6. is tantamount to an answer to 7.

### **QUESTION**

8. Does the phrase contained in TCA § 65-29-132, "This chapter shall be construed liberally." imply as a matter of law and policy that the subject chapter of the phrase necessarily supercedes other areas of state or federal law with which the subject chapter may be in conflict?

### **ANSWER**

Our research on this question does not reveal any statute, any reported case law in the state of Tennessee, or Attorney General's opinions which are available to this office that would give assistance in answering this question. In our opinion, the phrase "This chapter shall be construed liberally." simply means that its interpretation will be generous, not restrained, not interpreted literally or strictly. If there is any question as to the meaning of verbiage in the Tennessee Telephone Act, it should be interpreted favorably to carry out the purposes set out in the Act, and which would be in the public interest or policies, express or implied, in the Act itself.

If there are other state or federal laws which are in conflict with this chapter, the subject of conflict of laws come into play. This immediately requires a characterization of conflict questions. Then we have to go to the law applicable to the characterization process. Then we go to which laws have precedence over the other. Then we get into the rules of construction and interpretation of statutes, both state and federal, which quite frequently conflict. It would be difficult for BLC to state that the phraseology mentioned above, "This chapter shall be construed liberally." necessarily implies as a matter of law and policy that the subject chapter necessarily supersedes other areas of

state and federal law; however, we feel that the courts would decide that, by a liberal interpretation, it would assist in reaching the goals and policies set by the Legislature of the State of Tennessee and the federal government for universal telephone and/or telecommunications services which includes hard-to-serve low-density rural areas.

### **QUESTION**

9. As a matter of law and policy, how should the Authority resolve any conflict among relevant laws in a manner that best ensures that BLC, as a properly certified CTSP, would compete with other CTSPs "on a level playing field" and in compliance with Tennessee law?

### **ANSWER**

This question is very broad, and the first thing that came to mind was, What particular law or laws and what particular policy or policies does the Authority have in mind? The second thing to be considered was, What conflict and among what relevant laws is the Authority asking about? Then the next question that came to BLC to be considered was, What competitive telecommunications service provider is competing with BLC? There might be, under the definition given by Authority Rule 1220-4-8.01(f), a cellular operation or a PCS operation or paging operation which came into existence after June 6, 1995, but we understand that these operations do not require and do not fall under the jurisdiction of the Tennessee Regulatory Authority. The answer is simply this, in our opinion, Ben Lomand Communications, Inc. should be treated as a separate legal entity that it is, that it falls under the same rules and regulations as any other corporation organized and existing under the for profit corporate laws of the state of Tennessee duly certified by the Secretary of State of the State of Tennessee as a corporation and which has been certified by the Tennessee Regulatory Authority to do business in certain areas of the state of Tennessee as a competitive local exchange carrier or a competing telecommunications service provider certified for such service after June 6, 1995. Then simply apply the law as it exists. "On a level playing field" is

simply a nonexistent cliché. Some companies, because of their size have an advantage in purchasing, others because of their good payment record get lower interest rates, some by their efficiency and management are able to attract lower bond rates, some because of their service area get universal funds from a pool, and some by their certain characteristics have to pay fees or make contributions that others are not required to make.

### QUESTION

10. Discrepancies exist between BLC's statements regarding the federal and state tax exemptions enjoyed by BLRTC as found on page 37 of the December 15, 1998, transcript in Docket No. 98-00600 and on page 8 of BLC's August 29, 2000, data request response in Docket No. 00-00680. Please clarify what tax exemptions BLRTC or BLC enjoy under federal and state law.

### ANSWER

This is the personal response of James W. Dempster, Attorney for Ben Lomand Communications, Inc. I have reviewed page 37 of the December 15, 1998, transcript in Docket No. 98-00600 and also page 8 of BLC's August 29, 2000, data request response in Docket No. 00-00680. After a review of both of these pages, I can see where my answer on page 37 might be confusing. If the quote "we" is interpreted to reference Ben Lomand Communications, Inc., then that is incorrect. If the "we" is Ben Lomand Rural Telephone Cooperative, Inc., then the answer is correct. My response was to Director Greer's statement "Yes. You said that you enjoyed certain tax advantages as a cooperative." My answer was as to the cooperative, but, be that as it may, the correct answer is, and the one that I intended to convey to the Authority at that time was "telephone cooperatives chartered under or operating under the Telephone Cooperative Act are given certain tax advantages both state and federal that a corporation chartered under the for profit act of Tennessee corporations are not given.

Federally, certain organizations are exempt from tax. The federal exemption which I spoke of is 26 USCS § 501(c)(12)(A):

Benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations; but only if 85 percent or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses.

It is also possible under an electric cooperative case which involved a Tennessee electric cooperative that telephone cooperatives might also be exempt under 501(c)(3) wherein the district court held that the Pickwick Electric Cooperative could be exempt under two sections of 501(c).<sup>1</sup> The exemption for the state of Tennessee is found in TCA 65-29-129:

**65-29-129. No exemption from ad valorem taxes.** -- Nothing in this chapter shall be construed to exempt cooperatives and foreign corporations furnishing telephone service in this state pursuant to this chapter from ad valorem property taxes. Assessment schedules for such property shall be filed with the comptroller of the treasury. Cooperatives and foreign corporations shall also be subject to the sales and use tax under title 67, chapter 6. The payment of the above taxes shall be in lieu of all other taxes unless it is otherwise specifically provided by law.

Respectfully submitted, this 8<sup>th</sup> day of January 2001.

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<sup>1</sup>At the time of the Pickwick decision, 501(c)(3) & 501(c)(12) had different numbers.